

REGULATION OF THE SALE OF OIL AND GAS INTERESTS—OHIO AND FEDERAL

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INTRODUCTION

Many persons not directly connected with oil and gas exploration and development are surprised to learn that developers and producers often run afoul the laws concerning the regulation of the sale of securities. It must be realized, however, that a major segment of such exploration and development is accomplished by independent oil operators, rather than by the well-known and well-financed major oil companies. Though major integrated oil companies market most of the petroleum and petroleum products used in the United States, small companies and individuals do spend a large amount of the risk capital which is annually used for exploration and development of oil reserves.

This risk capital is often raised from outside investors and the sale of oil and gas interests to such investors has therefore come under the scrutiny of legislators who seek to protect the public from unscrupulous promoters. Laws requiring the registration of such sales or of the seller are the result.

The State of Ohio, long a significant producer of petroleum and its derivatives, is no exception to the rule. Chapter 1707 of the Ohio Revised Code, which regulates the sale of all securities in Ohio, clearly encompasses within its jurisdiction, almost all types of oil and gas financing arrangements.¹ Moreover, the Securities Act of 1933 often covers oil and gas financing plans which are interstate in nature.² This article will attempt to touch upon the main areas of legal concern in the financing of oil and gas operations in regard to both the Ohio and Federal regulatory machinery.

TYPICAL FINANCING PLANS

When an independent operator decides to drill an exploratory well for oil or gas, his financing plan often involves the sale of undivided interests in the oil and gas lease and/or the proposed well in order to raise the necessary risk capital. It is not uncommon for the operator or promoter to receive enough for such interests to

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¹ Ohio Rev. Code Ann. § 1707.01(B) (Page 1964).

² Securities Act of 1933, 48 Stat. 74 (1933), 15 U.S.C. §§ 77a-77aa (1964).

drill the well without any personal contribution of his own. It is the sale of such undivided interests which creates the most problems with the regulatory statutes which will be discussed in this article.

Major oil companies encourage independent investment by the use of "farm-out" agreements in which an independent is promised an assignment of oil and gas leases held by the major company if the independent will immediately drill an exploratory well on the property covered by the agreement. The assigning company keeps other acreage in the immediate area of the well, this other acreage to be developed should the independent's well be successful. It is not uncommon for the assigning company to retain an overriding royalty interest in the leases to be assigned. If the independent needs further encouragement, the assigning company may also promise to contribute a specified amount of "dry hole money" if the well is dry or of "bottom hole" money upon the successful completion of the well. Since the person taking the "farm-out" must drill a well and since he usually will not personally want to take the full risk, these arrangements often lead to the ultimate sale to investors of undivided interests in the assigned oil and gas leases.

STATE AND FEDERAL REGULATION— A GENERAL COMPARISON

There is a basic philosophic difference between the coverage of the Federal Securities Act,³ and the Ohio Securities Act.⁴ The Securities Act of 1933 requires full disclosure of all pertinent information to the investor. No attempt is made to pass upon the fairness or the investment merit of the offering. There are both criminal and civil penalties prescribed for failure to make such full disclosure and for misrepresentation. After full disclosure, the investor is left to make his own decision regarding the merit of the offering. The offeror is prohibited from representing that the Securities and Exchange Commission has passed upon the fairness or relative merit of the offering.⁵

On the other hand, the Ohio Securities Act, like many state securities laws, authorizes the administrative machinery to look into the fairness of the offering.⁶ This scrutiny of the business merit

³ *Ibid.*

⁴ Ohio Rev. Code Ann. ch. 1707 (Page 1964).

⁵ SEC Securities Act Release No. 33-3225, June 23, 1947, as amended. SEC Securities Act Release No. 33-3424, Aug. 28, 1951.

⁶ Ohio Rev. Code Ann. § 1707.09 (Page 1964). The statute allows the Ohio Securities Division to register a security by qualification "if the Division finds that the business of the issuer is not fraudulently conducted, that the proposed offer or disposed of securities is not on *grossly unfair terms*. . . ." (Emphasis added.) See also Wright, "Correlation of State Blue Sky Law and the Federal Securities Act," 26 Cornell L.Q. 256 (1941).

of the offering is in addition to the other requirements of the act, *viz.*, complete disclosure of the facts involved in the offering,⁷ the background examination of the issuer,⁸ and the selling intermediary.⁹ The administrative difficulty of determining whether an offering is "grossly unfair" in the context of the sale of highly speculative oil and gas interests is apparent. The Ohio Division of Securities has, however, set out some administrative guidelines for security offerings. These guidelines will be discussed below.

THE OHIO SECURITIES ACT

The Ohio Securities Act became effective on July 22, 1929.¹⁰ It replaced the original "Ohio Blue Sky Law" which was enacted in 1913.¹¹ The 1929 law is largely intact today, only minor changes having been made since enactment. It should be noted that the Ohio law preceded the Securities Act of 1933,¹² which latter legislation set the pattern for the "full disclosure" laws enacted thereafter.

From the beginning it was apparent that the Ohio General Assembly intended to make the Securities Act applicable to the financing plans prevalent in the petroleum industry. Provisions making specific reference to oil and gas interests were part of the 1929 Securities Act. In spite of this, it is surprising to find that there is little or no authority on the interpretation of the law as it applies to oil and gas interests. Most oil operators who, prior to this decade, have centered their operations in Ohio apparently became accustomed to compliance. Recent renewed oil activity centered in Morrow County brought scores of new operators and promoters to Ohio. It is safe to say that compliance with the Ohio Securities Act was largely ignored by the new promoters. The Securities Division has recently been conducting an extensive investigation into these activities. Several indictments and convictions under the criminal sanctions of the act have resulted and it can be expected that more will follow.

Oil and Gas Interests as Securities

The Ohio Securities Act defines the term "security" as follows:

(B) "Security" means any certificate or instrument which represents title to or interest in, or is secured by any lien or charge

⁷ Ohio Rev. Code Ann. §§ 1707.05-.09 (Page 1964).

⁸ Ohio Rev. Code Ann. § 1707.15 (Page 1964).

⁹ Ohio Rev. Code Ann. § 1707.16 (Page 1964).

¹⁰ 113 Ohio Laws 216-47 (1929).

¹¹ 103 Ohio Laws 743-53 (1913).

¹² Securities Act of 1933, 48 Stat. 74 (1933), 15 U.S.C. §§ 77a-77aa (1964).

upon, the capital, assets, profits, property, or credit of any person or of any public or governmental body, subdivision, or agency. It includes shares of stock, certificates for shares of stock, voting-trust certificates, warrants and options to purchase securities, subscription rights, interim receipts, interim certificates, promissory notes, all forms of commercial paper, evidences of indebtedness, bonds, debentures, land-trust certificates, *fee certificates, leasehold certificates, syndicate certificates, endowment certificates, certificates or written instruments in or under profit-sharing or participation agreements or in or under oil, gas, or mining leases, or certificates or written instruments of any interest in or under the same*, receipts evidencing preorganization or reorganization subscriptions, preorganization certificates, reorganization certificates, *certificates evidencing an interest in any trust or pretended trust, any investment contract*, any instrument evidencing a promise or an agreement to pay money, warehouse receipts for intoxicating liquor, and the currency of any government other than those of the United States and the Dominion of Canada *but such sections shall not apply to bond investment companies or to the sale of real estate*. "Security" shall, for the purposes of such sections, *be deemed to include real estate not situated in this state and any interest in real estate not situated in this state*.¹³

It is apparent that the legislators who drafted this definition intended to cover almost every financing scheme which can be contrived by promoters. It is also clear that oil and gas financing plans are within the intended coverage.

The great majority of oil and gas financing plans involve the sale of "certificates or written instruments in or under profit-sharing or participation agreements or in or under oil, gas, or mining leases, or certificates or written instruments of any interest in or under the same. . . ." ¹⁴ Consequently in such cases, there is no problem of showing that the promoters in such plans are involved in the sale of securities within the meaning of the act.

Promoters in the petroleum industry have been diligent in their attempts to develop plans which do not involve the sale of securities. These, however, meet with little success in view of the additional broad language contained in the definitions. Receipts evidencing payment for partial interests in oil and gas projects, trust agreements wherein the trustee is to develop oil properties on behalf of the beneficial owners, and certain types of partnership interests all fall within at least one of the classifications mentioned in the definition.

The term "investment contract" has been used to encompass arrangements which do not neatly fall within one of the other classifications. As stated above, Ohio authority on the coverage

¹³ Ohio Rev. Code Ann. § 1707.01(B) (Page 1964). (Emphasis added.)

¹⁴ *Ibid.*

of the act is scant. In *State v. Silberberg*,¹⁵ the Supreme Court of Ohio considered the term "investment contract" as used in the definition of security. The court first observed that: "The courts have had difficulty in determining what constitutes a 'security.' As a rule they have preferred not to work out an all-inclusive definition, but have chosen to draw the lines of demarcation as the circumstances of each case present themselves."¹⁶

Moving to the question of the term "investment contract" the court stated that the test is whether or not the purchaser or investor gains an appreciable degree of control over the business venture in which he has invested. If this control is lacking and the purchaser is simply to share in the returns from the venture which is being controlled by the seller or another party, the arrangement will be considered to be an investment contract.¹⁷

The Ohio Securities Act specifically excludes the sale of real estate from the definition of security.¹⁸ This exclusion is also considered and discussed in *State v. Silberberg*.¹⁹ The defendant in this case sold undivided unit interests in certain apartment buildings. The defendant agreed to set up a corporation capitalized at the amount of the sale price of the building and to issue shares in the corporation to the purchaser of the undivided interest in the real estate in proportion to the unit interest purchased. The buildings were then to be conveyed to the corporation. It was contended that the sale was an investment contract and that it therefore fell within the registration requirements of the Ohio Securities Act.

The Supreme Court of Ohio held that if the purchaser is to occupy the premises and conduct the enterprise it will not be considered as an investment contract but as a sale of real estate. The court concluded that the facts in the *Silberberg* case indicated that such was the case.²⁰

It can be argued that certain types of oil and gas transactions would be considered sales of real estate under this rationale. Consider for instance a typical farm-out arrangement wherein the owner of a leasehold interest agrees to assign such interest in whole

¹⁵ 166 Ohio St. 101, 139 N.E.2d 342 (1956).

¹⁶ *Id.* at 104, 139 N.E.2d at 344.

¹⁷ See *SEC v. C. M. Joiner Leasing Corp.*, 320 U.S. 344 (1944); *Goldberg v. Paramount Oil Co.*, 300 P.2d 329 (Cal. Ct. App. 1956); *State v. Ogden*, 154 Minn. 425, 191 N.W. 916 (1923).

¹⁸ The definition of security does include real estate *not* situated in Ohio or any interest therein. This coverage is pertinent in the oil and gas field since promoters often sell interests in out-of-state investments including entire oil and gas leases which might be exempt but for this inclusion.

¹⁹ *Supra* note 15.

²⁰ *Ibid.* See generally *Hathaway v. Porter Royalty Pool, Inc.*, 296 Mich. 90, 295 N.W. 571 (1941).

or in part to another party in return for the drilling of a well on the acreage involved. The assignor can argue, even though he retains a fractional interest in the assigned leasehold interests, that he has made a transfer of real estate since the taker of the farm-out usually agrees to take possession and conduct the operations himself. Unfortunately, however, the lack of authority in Ohio means it is uncertain that such an argument will be sustained.

Section 1707.01(C)(1) defines the term "sale" as having the full meaning of the term as applied by or accepted in the courts, including every disposition, or attempt to dispose of a security or an interest therein. It includes, according to the statute, a contract to sell, an exchange, an attempt to sell, an option of sale, a solicitation of a sale, a solicitation of an offer to buy, a subscription, or an offer to sell, directly or indirectly, by agent, circular, pamphlet, advertisement, or otherwise. To "sell" means any act by which a sale is accomplished.²¹ Obviously, this language was meant to be as all-inclusive as the definition of security discussed above.

The term "person" under the Ohio Securities Act is defined to include a natural person and all common business organizations, *e.g.*, partnerships, limited partnerships, partnership associations, syndicates, and corporations.²²

An "institutional investor" under the act means any corporation, bank and insurance company as well as pension funds or pension trusts, employees' profit-sharing trusts or other associations engaged in purchasing or holding securities.²³ This latter definition makes a sale of securities to a corporation as well as the other types of institutional investor exempt under the provisions of section 1707.03(D). This exemption will be discussed more fully below.

Exempt Transactions

It should be noted that the mere fact the oil or gas property which is the subject of a money-raising plan is located in Ohio does not necessarily make the sale subject to the Ohio Securities Act. On the contrary, if the sale of the interests is made *entirely* outside of Ohio, the Ohio authorities would not have jurisdiction. One caveat should be noted, however. The broad definition of "sale" makes it very easy to inadvertently make a sale within Ohio when dealing with an Ohio property. Great care should be taken to avoid this possibility if lack of jurisdiction is to be relied upon. In addition, of course, the fact that the sale is made elsewhere should

²¹ Ohio Rev. Code Ann. § 1707.01(C)(2) (Page 1964).

²² Ohio Rev. Code Ann. § 1707.01(D) (Page 1964).

²³ Ohio Rev. Code Ann. § 1707.01(S) (Page 1964).

cause the offeror to consider the Federal Securities Act of 1933 and the appropriate Blue Sky Laws of the state where the sale is made.

A sale by the bona fide owner of a security who is neither an issuer nor a dealer, which sale is not made for the purpose of avoiding the Securities Act nor as a part of a series of repeated transactions, is exempt from registration under the Ohio act.²⁴ This exemption means that the owner of an undivided interest in an oil and gas lease can sell his interest without registration. If, however, he fractionalized his interest and sold portions thereof in repeated transactions, the exemption would be lost both because of the successive transactions and because the seller could be considered an issuer under those circumstances.

Sales to the issuer himself, to a dealer, or to institutional investors are exempt.²⁵ This exemption has become very broad because any corporation is considered to be an institutional investor under the act. The exemption was apparently created because the General Assembly felt that such investors did not need the protection of the act.

A specific exemption is available to promoters in the petroleum industry in certain situations under section 1707.03(P). This section exempts the sale of securities representing interests in or under profit-sharing or participation agreements relating to oil or gas wells located in this state, or representing interests in or under oil or gas leases of real estate situated in this state if certain conditions are complied with. The sale must have been made by an individual or some form of a business association other than a corporation.

The first condition set forth in the exemption section is the most limiting. It reads as follows: "The beneficial owners of such securities do not, and will not after such sale, exceed five natural persons."²⁶ It should be noted that the numerical requirement does not apply to the number of purchasers but to the number of beneficial owners which hold interests in the oil and gas well after the sale. In addition the requirement further limits the exemption by the fact that the beneficial owners must be natural persons rather than "persons" as defined in the act.²⁷ In order to be exempt the securities offered also must constitute or represent interests in only one oil or gas well. Also, a written certificate must be furnished each purchaser of such securities before the consummation of the sale, which certificate discloses the maximum commission, compensation for services, costs of lease, and expenses with respect to the

²⁴ Ohio Rev. Code Ann. § 1707.03(B) (Page 1964).

²⁵ Ohio Rev. Code Ann. § 1707.03(D) (Page 1964).

²⁶ Ohio Rev. Code Ann. § 1707.03(P)(1) (Page 1964).

²⁷ Ohio Rev. Code Ann. § 1707.01(D) (Page 1964).

sale of such interests and with respect to the promotion, development, and management of the well. The total of such commission, compensation, costs, and expenses may not exceed 25 per cent of the aggregate interests in the well, exclusive of any landowner's rental or royalty.²⁸

This exemption of a sale to less than five persons is often claimed by promoters in the oil and gas industry. Unfortunately, most such claimants do not bother to give the purchasers the written certificate required by the exemption provision. No filing is necessary if the sale is within the exemption. However, since exemptions are normally strictly construed and since the burden of proof to show the exemption would be on the issuer,²⁹ it is strongly suggested that each specific provision of the exemption be followed carefully.

This limitation, *i.e.*, a 25 per cent limit on the commissions, compensation, and expenses of the promoter, is apparently the source of the rule followed by the Ohio Securities Division that limit promoters to a 25 per cent take in regard to all issues of securities whether or not they require registration. The division apparently has determined that any amount in excess of 25 per cent is grossly unfair under the terms of the act. This is an administrative decision and has not as yet been tested in the courts. It can be argued that the 25 per cent limit should not be equated with the question of fairness when the additional protection of registration is involved.

Registration by Description

If a financing plan does not fall within one of the narrow exemptions discussed above, and most do not, registration must take place. The only remaining question is whether to register by description or by qualification. Securities requiring registration by description are listed in sections 1707.05-.06. All other sales of securities which must be registered but which do not fall within the provisions allowing descriptive registration must be registered by qualification under the terms of section 1707.09.

Registration by description requires the filing of certain prescribed forms verified under oath. The pertinent forms used for registration by description of oil and gas interests are Securities Form 6(A)(3)OG and 6(A)(3).

These forms are used under the authority of section 1707.06(3) which states that the sale of securities representing an interest in a partnership, limited partnership, partnership association, syndicate, pool, trust, trust fund, or other unincorporated associations may be carried out if registration by description has been accomplished.

²⁸ Ohio Rev. Code Ann. § 1707.03(P)(3) (Page 1964).

²⁹ See Ohio Rev. Code Ann. § 1707.45 (Page 1964).

The number of persons interested in such sale or in any part of the subject matter of the sale may not, after such sale, exceed ten. The statute in this cases uses the term "persons" and not the term "natural persons" and it would seem that the definition of the term "persons" as set out in the original definition section of the Securities Act³⁰ should apply.

Under this section no commission or other remuneration may be paid to the issuer in connection with the sale either directly or indirectly. The total sales expense may not exceed one per cent of the total sales price, and, of course, the sale must be made in good faith and not for the purpose of avoiding the other sections of the Securities Act.³¹

The rules set out in the last section are incorporated into the Securities Division Forms 6(A)(3)OG and 6(A)(3). These forms are used, respectively, for the sale of oil and gas interests, and for the sale of interests in most types of unincorporated associations.

A corporation organized under the laws of Ohio may sell its securities under a registration by description if the securities are sold for cash and if the total commission, remuneration or expense connected with such sale does not exceed three per cent of the total sales price.³² This section is not commonly used by oil and gas promoters since the limitation on commissions is very restrictive.

One of the primary advantages of the use of registration by description is that the seller does not need a dealer's license as he does with regard to registration by qualification. A primary danger with the use of such registrations under the authority of section 1707.06(A)(3) is that the sale is limited to ten persons. This creates a problem should one of the original purchasers fractionalize his interest and resell the smaller fractional interests making greater than ten the total number of persons holding interests. This is analogous to the problem encountered under the so-called "intra-state" exemption of the Federal Securities Act of 1933, when a resident purchaser resells to a nonresident of the state wherein the offer was made.³³

In the latter case, the Securities and Exchange Commission has suggested a test which determines whether the ultimate distribution had been completed before the resale of the security by the original purchaser. If it is found that the distribution had been completed, the subsequent sale would probably not destroy the

³⁰ Ohio Rev. Code Ann. § 1707.01(D) (Page 1964).

³¹ Ohio Rev. Code Ann. § 1707.06(A)(3) (Page 1964).

³² Ohio Rev. Code Ann. § 1707.06(A)(1) (Page 1964).

³³ See discussion accompanying notes 84-92, *infra*, in regard to intrastate exemption under Securities Act of 1933, 48 Stat. 906 (1933), as amended, 15 U.S.C. § 77c (1964).

exemption. A similar test apparently could be applied in the case of the ten-person limitation, but no Ohio authority exists. Certainly the descriptive registration could not be used if the issuer knew of a planned further distribution which would exceed the ten-person limitation.

A registration by description must be accompanied by the payment of a fee prescribed in the statute.³⁴ When the registration has been filed and the fee paid the issuer may begin the sale. Under this provision the Division of Securities is not given any discretion as to the fairness of the issue. However under section 1707.13 the Division of Securities is granted the power to suspend a registration by qualification or a registration by description if any one of several conditions is found, *e.g.*, the security is being disposed of on grossly unfair terms. This has the effect of allowing the division to examine registrations by description for fairness *after* they are registered. In practice the division examines the registration before it is filed and applies certain non-statutory requirements such as the twenty-five per cent limitation mentioned above in the discussion of the exemption allowed by sales to less than five informed persons.

Registration by Qualification

All sales of securities neither exempt nor within the privilege of registration by description must be registered by qualification.³⁵ Under this form of registration the Division of Securities examines the offering issue to determine that it is not on grossly unfair terms and that it would not defraud or deceive, or tend to defraud or deceive the purchasers of the issue.³⁶ The issuer must, after the sale, receive no less than 85 per cent of the proceeds of the sale.³⁷ This prevents excessive commissions and expenses. The sale must be made by a dealer licensed under the provisions of other sections of the act.

Registration by qualification of the sale of oil and gas interests is accomplished on Securities Division Form 9 OG, and the Securities Division recommends the use of an offering circular containing the same information as is required for an S-10 Federal Registration.³⁸ There is no monetary limitation on a registration by qualification and a sale of interests in several wells may be accomplished in one registration.

³⁴ Ohio Rev. Code Ann. § 1707.08(E) (Page 1964). The fee is \$25 in the case of registration under Securities Division Form 6(A)(3)OG or 6(A)(3).

³⁵ Ohio Rev. Code Ann. § 1707.09 (Page 1964).

³⁶ Ohio Rev. Code Ann. § 1707.09(K) (Page 1964).

³⁷ Ohio Rev. Code Ann. § 1707.09(J) (Page 1964).

³⁸ See discussion of registration under Securities and Exchange Commission Form S-10, accompanying note 106 *infra*.

Certain common exhibits are required under registration by description or qualification, *e.g.*, a copy of the lease or leases involved, a specimen copy of the security to be issued, a copy of any operating agreement which is contemplated, an attorney's title opinion showing good title in the issuer as to the leasehold interests involved (or binding contractual rights to obtain such title), an opinion of counsel as to the validity of the security and a plat showing the location of proposed wells.

Licenses

Dealers and salesmen involved in the sale of oil and gas securities must be registered under the provisions of the Securities Act.³⁹ References and a showing of financial responsibility are required, and a dealer must have a minimum net worth of 10,000 dollars. The licenses expire annually and must be renewed. When a dealer is involved in the sale of oil and gas securities it is common to grant him a dealer's license only for such securities. A salesman may only be licensed to one dealer, and if he severs his relationship with that dealer his license is void.⁴⁰

Enforcement and Penalties

Any sale made in violation of the Ohio Securities Act is voidable at the election of the purchaser.⁴¹ The provision providing civil liability makes not only the non-complying issuer liable to the purchaser for the full amount of the purchase price and costs of the suit, but it makes "every person who has participated in or aided the seller in any way" jointly and severally liable therefor.⁴² The civil statute of limitations, being two years from the date of the sale or contract of sale,⁴³ means that an investor can purchase an unregistered oil or gas interest in a proposed well, await determination as to whether the well is a commercial producer, and, if not, receive all of his money back at any time within two years after the sale.

Section 1707.99 provides the criminal penalties for violation of the act. It provides a fine of not more than 5,000 dollars, imprisonment for not less than one year nor more than five, or both the fine and prison term. There is a three-year statute of limitations as to the criminal sanctions.⁴⁴

³⁹ Ohio Rev. Code Ann. §§ 1707.14-.19 (Page 1964).

⁴⁰ Ohio Rev. Code Ann. § 1707.16 (Page 1964).

⁴¹ Ohio Rev. Code Ann. § 1707.43 (Page 1964).

⁴² *Ibid.*

⁴³ *Ibid.*

⁴⁴ Ohio Rev. Code Ann. § 1707.28 (Page 1964).

SECURITIES ACT OF 1933

The preamble of the Securities Act of 1933 states that it is the intention of the act "to provide full and fair disclosure of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof, and for other purposes."⁴⁵

Section 5(a) of the Securities Act of 1933⁴⁶ declares that it is unlawful to directly or indirectly make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell or offer to buy a security unless a registration statement is in effect for that security.⁴⁷ The far-reaching scope of this prohibitory language is apparent. The courts have consistently supported the avowed statutory purpose of this act by holding that it must be liberally construed.⁴⁸ The purposes of the Securities Act of 1933 and this rule of construction must be kept in mind when placing the sale of oil and gas interests into the statutory context.

Oil and Gas Interests as Securities

Section 2(1) of the Securities Act of 1933, while not including as many specific examples as the Ohio Securities Act, similarly defines security in the following broad manner:

(1) The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, *certificate of interest or participation in any profit-sharing agreement*, collateral-trust certificate, preorganization certificate or subscription, transferable share, *investment contract*, voting-trust certificate, certificate of deposit for a security, *fractional undivided interest in oil, gas, or other mineral rights*, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. (Emphasis added.)

Under this definition each of the italicized clauses could be used to encompass some of the oil and gas financing plans which have been used by promoters.

The most obvious applicable language is the express inclusion of a "fractional undivided interest in oil, gas, or other mineral rights . . ." as a security. This extends coverage to the most commonly

⁴⁵ 48 Stat. 74 (1933).

⁴⁶ Securities Act of 1933, 48 Stat. 74 (1933), as amended, 15 U.S.C. §§ 77a-77aa (1964).

⁴⁷ Securities Act of 1933, 48 Stat. 77 (1933), as amended, 15 U.S.C. § 77e (1964).

⁴⁸ See SEC v. C. M. Joiner Leasing Corp., *supra* note 17; Creswell-Keith, Inc. v. Willingham, 264 F.2d 76 (8th Cir. 1959).

used method of oil and gas financing: the sale of fractional undivided portions of the working interest in an oil and gas lease or well. The consequence of this language is that a promoter, when using this form of financing plan, automatically finds that he is selling a security within the definition of the law and he must look to one of the exemptions to be discussed below if he is to avoid the necessity of registration.

Promoters have, of course, originated modes of financing which are designed to avoid this coverage as well as the coverage of the Ohio Securities Act. However, most of these attempts have been countered with the liberal construction of other language in the definition such as "certificate of interest or participation in any profit-sharing agreement" or "investment contract." A significant example of this type of construction is found in *SEC v. C. M. Joiner Leasing Corp.*⁴⁹ There, an exploratory well was to be financed by the sale of oil and gas leases covering small parcels of acreage which formed a part of a block of acreage already held by the promoter, Joiner. The offered leasehold interests covered tracts never exceeding twenty acres; most tracts were between two and one-half to five acres in size. In other words, instead of selling small undivided fractional interests in the entire block, Joiner was selling each investor all of the leasehold interest in a small tract. The prices ranged from five to fifteen dollars per acre and the largest single purchase was for one hundred dollars. Sales literature represented that Joiner was drilling a test well so located as to be a test of the oil potential of the acreage offered for sale.

The Court concluded that the aim of the promotion was to connect Joiner's exploration operations with the sale of the leasehold interests in the small tracts. Purchasers were not left on their own to develop their purchases. Upon these facts the Court held that "the trading in these documents had all the evils inherent in the securities transactions which it was the aim of the Securities Act to end."⁵⁰ It was felt that the definition of the term "security" as used in the Securities Act of 1933 was broad enough to include such a transaction under the language "investment contract" or "any interest or instrument commonly known as a security."

The test of what constitutes an investment contract within the definition is further illuminated in *SEC v. W. J. Howey Co.*⁵¹ There the Supreme Court defined "investment contract" as an investment of money in a common enterprise with expectation that the investor

⁴⁹ *Supra* note 17.

⁵⁰ *Supra* note 17, at 349.

⁵¹ 328 U.S. 293 (1946).

"would earn a profit solely through the efforts of the promoter or of someone other than themselves."⁵²

Similarly the courts have thwarted other diverse schemes to take investments out of the definition of security. For example, in *SEC v. Crude Oil Corp.*,⁵³ the court found a sale of an investment contract where the purchasers were offered a bill of sale covering a specified number of barrels of oil. The purchasers actually received only the proceeds from the sale of oil from the involved royalty interests held by the seller.

From these cases it is apparent that participation of the purchaser in the control of an enterprise has become significant in determining whether or not a financing plan involves the sale of securities within the statutory definition. In cases such as *Woodward v. Wright*⁵⁴ where this control has been present, courts have rendered decisions finding that investment contracts were not involved. In the *Woodward* case, the defendant was at one time the operator of the oil and gas lease involved. He then participated in the sale to the plaintiffs of almost all interest ($1\frac{5}{16}$) in the lease. The plaintiffs, however, had dismissed the defendant after they became dissatisfied with the operation. This action convinced the court that the purchasing plaintiffs were in control of the enterprise; it was therefore held that the sale did not involve an investment contract within the definition.

It can thus be concluded that almost all of the variations of financing plans contrived by the promoters of oil and gas operations will be considered securities. Whether the form of financing be a syndicate, a royalty pool, a limited partnership, or some form of business trust, the courts will look to the substance of the transaction, and not to the form.⁵⁵

Exemptions

Seller Not Issuer, Dealer, or Underwriter

The Federal Securities Act expressly exempts transactions by any person other than an issuer, underwriter, or dealer.⁵⁶ The term "issuer" is specifically defined in the oil and gas context as an owner of mineral rights or interests who, for the purpose of public offering,

⁵² *Id.* at 301. The Court emphasized such other factors as the purchaser's distance from the subject of the investment, his experience in such investments, and the fact that the tracts were too small for individual development.

⁵³ 93 F.2d 844 (9th Cir. 1937).

⁵⁴ 266 F.2d 108 (10th Cir. 1959).

⁵⁵ *SEC v. Universal Serv. Assoc.*, 106 F.2d 232 (7th Cir. 1939).

⁵⁶ 48 Stat. 74 (1933), 15 U.S.C. § 77d(1) (1964).

creates fractional interests therein.⁵⁷ It does not matter whether the owner's original interest was the whole interest or a fractional one.⁵⁸

The term "dealer" covers any person who engages for all or part of his time, directly or indirectly, as agent, broker, or principal, in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person.⁵⁹ An underwriter is defined by the Securities Act as a person selling securities on behalf of an issuer as a part of the distribution of the security or who purchases them from an issuer with a view to distribution.⁶⁰ Included is any person who participates, either directly or indirectly, in selling or buying as part of distribution. As a practical matter it is difficult to determine who the underwriters are without first defining who the issuer is. Both an issuer and underwriter are subject to the registration requirements of the Securities Act.

It is not uncommon for a promoter to raise money for exploration and development of leasehold interests though he legally does not own the interest. This might occur under a typical farm-out arrangement wherein the promoter receives a promise from the legal owner of the leasehold that the drill site and other acreage will be transferred to him when he complies with certain conditions of the agreement. Usually the primary condition is that a well be drilled within a short time. In this situation, because the promoter is not the owner, the question arises as to whether or not he is an issuer as set out above. He is really selling a fractional interest in an expectancy. In spite of this discrepancy between the statutory language and the technical facts a promoter selling fractional interests on the basis of such a farm-out will be classified as an issuer within the terms of the act.⁶¹

Similarly, a person who is not himself making a public offering may, in the terms of the act, be an issuer if he is subdividing his rights or interest "for the purpose of public offering" even though other parties are to make the offering.⁶²

The question arises as to the status of the original lessee or owner of the leasehold interest in the farm-out situation described above. If such owner was aware that the person taking the farm-out planned to obtain funds for development by the sale of interests to the public, and if the owner retained a portion of the working inter-

⁵⁷ 48 Stat. 74 (1933), 15 U.S.C. § 77b(4) (1964).

⁵⁸ 48 Stat. 74 (1933), 15 U.S.C. § 77b(4) (1964).

⁵⁹ 48 Stat. 74 (1933), 15 U.S.C. § 77b(12) (1964).

⁶⁰ 48 Stat. 74 (1933), 15 U.S.C. § 77b(11) (1964).

⁶¹ 1 CCH Fed. Sec. L. Rep. ¶ 1252.

⁶² See SEC Statement in Compilation of Rules, Regulations and Opinions Applicable to Oil and Gas Interests (1935).

est in the well or lease, it appears that the original owner might be classed as an issuer. Authority is lacking but past policy of the Securities and Exchange Commission indicates that if the original owner assigns all of the working interest in the lease and also retains an overriding royalty or a production payment, the lease has not been fractionalized within the terms of the statutory definition of issuer.⁶³ By the same token the owner of the landowner's royalty ordinarily would not be considered an issuer when he sells his entire royalty interest where he has no part in a planned resale of the interest.⁶⁴

If a finding is made that an original assignor in one of the above situations is an issuer under the terms of the Securities Act, the entire offering may involve two issuers. The second person who further fractionalizes the interest for public sale may well find himself in the dual role of issuer and underwriter. He would be an underwriter because he had acquired from an issuer with a view to the distribution of the security. In such a case the Commission has suggested that the original assignor register the sale.⁶⁵

Private Offerings

Most oil and gas promoters would be very surprised to learn that a sale to four persons could be a public offering of securities under the Securities Act of 1933. Yet the United States District Court of Colorado recently held such to be the case.⁶⁶ It is a common misconception that an offering must involve a fair sized group of offerees or purchasers to be considered a public offering. The authorities support an opposite conclusion.

The Securities Act of 1933 exempts those "transactions by an issuer not involving a public offering."⁶⁷ As seen above, the definition of issuer with respect to fractional undivided oil, gas, or mineral interests means the owner of any such right "who creates fractional interests therein for the purpose of *public offering*."⁶⁸ Thus, both sections of the act make a public offering a prerequisite to applicability. However, the term "public offering" is not defined in the statute thereby permitting the misconception noted above.

At one time it was a generally accepted rule that offers of securities to less than twenty-five offerees was a private offering not

⁶³ Bloomenthal, "SEC Aspects of Oil & Gas Financing," 7 Wyo. L.J. 49 (1953).

⁶⁴ SEC Statement in Compilation of Rules, Regulations and Opinions Applicable to Oil and Gas Interests (1935).

⁶⁵ 1 CCH Fed. Sec. L. Rep. ¶ 1257.

⁶⁶ *Repass v. Rees*, 174 F. Supp. 898 (D. Col. 1959).

⁶⁷ 48 Stat. 74 (1933), 15 U.S.C. § 77d(1) (1964).

⁶⁸ 48 Stat. 74 (1933), 15 U.S.C. § 77b(4) (1964). (Emphasis added.)

requiring registration.⁶⁹ While this rule is still recognized as a factor in determining whether or not a public offering has been made,⁷⁰ other factors have come to be considered equally important.

In *SEC v. Ralston Purina Co.*⁷¹ Mr. Justice Clark stated that the need to define the scope of the private offering exemption had arisen many times and that this prompted the granting of certiorari.⁷² The case involved the sale of defendant's stock "to employees . . . who shall without solicitation by the company or its officers or employees, inquire of any of them as to how to purchase common stock of Ralston Purina Company."⁷³ Under this plan the stock was sold to employees holding widely divergent types of jobs in the company. The number of employees who purchased ranged from a low of 20 in 1948 to a high of 414 in 1949. No record was kept as to the number of persons to whom offers were made.

The defendant, Ralston Purina Co., contended that the offering was only to "key employees" of the company and was therefore a private offering. The court rejected the contention, citing *SEC v. Sunbeam Gold Mines Co.*⁷⁴ In the latter case it was observed, in a discussion of the meaning of the term "public," that "an offering of securities to all red-headed men, to all residents of Chicago or San Francisco, to all existing stockholders of the General Motors Corporation or the American Telephone & Telegraph Company, is no less 'public' . . ." than an offering to the world at large.⁷⁵

The Supreme Court in *Ralston Purina Co.* concluded that the determination of what is a public offering should turn on whether the particular class of persons affected needs the protection of the act. On examining the facts of the case to determine the need of the employees of the Ralston Purina Co. for the protection of the act, the Court stressed the relationship between the offerees and the issuer and the offerees' access to pertinent information. The Court held that the need was present and therefore that a public offering had been made.

The Supreme Court's ruling in the *Ralston Purina Co.* case was intended to clarify the private offering exemption, but the test adopted is subject to a wide latitude of interpretation. Some writers

⁶⁹ SEC Securities Act Release No. 33-285, Jan. 24, 1935.

⁷⁰ 1 Loss, Securities Regulations 662 (2d ed. 1961).

⁷¹ 346 U.S. 119 (1953).

⁷² The SEC had originally brought an action to enjoin the unregistered stock offerings of the Ralston Purina Co. The district court held the offerings to be within the private offering exemption, 102 F. Supp. 964 (E.D. Mo. 1952), and the court of appeals affirmed, 200 F.2d 85 (8th Cir. 1952).

⁷³ *Supra* note 71, at 121.

⁷⁴ 95 F.2d 699 (9th Cir. 1938).

⁷⁵ *Id.* at 701.

have concluded that the number of offerees is now irrelevant.⁷⁶ Others feel that the old rule of thumb and the test applied in the *Ralston Purina Co.* case are not inconsistent.⁷⁷ One court in a recent case has applied the rule of thumb along with the other relevant factors such as the relationship between the issuer and the offerees, the manner of offering, and the access of the offerees to the pertinent information.⁷⁸

Application of the *Ralston Purina Co.* test in the context of oil and gas financing should not become unwieldy if emphasis is placed on the offeree's need. Exemption based on the number of offerees alone has been rejected.⁷⁹ Some factors which must be considered in determining the offeree's need are: (1) the relationship between the offeror and offerees; (2) the size of the offering; (3) whether the offerees have access to the information needed; (4) the experience of the purchasers; (5) the willingness of the offeror to sell to anyone; (6) the mode of distribution; and (7) the offeree's purpose in purchasing (investment or resale).⁸⁰ The burden of proof is on the issuer to sustain the contention that a private offering exemption is present.⁸¹ At the same time, the terms of the exemption will be strictly construed against the claimant.⁸²

When these factors and rules of construction are taken into consideration it is obvious that many oil and gas financing arrangements could not be considered a private offering even though only a few purchasers are involved. Most promoters in the petroleum industry are willing to sell to anyone who can supply the necessary risk capital for the promoter's operation. Most investors do not have access to the necessary information in regard to the interest being sold. Usually, the promoter alone has centered his activities around the prospective investment and the scientific factors involved therein. The relationship between promoter and investor will, of course, vary but often that relationship will not be close.

The inherent danger in a promoter's reliance on the private offering exemption is obvious. Facts unknown to the promoter can easily place him outside the exemption. Although the offeror may make application for a "no action" ruling from the Commission, such a ruling will not preclude a purchaser's civil action. A court in a subsequent examination of the facts could negate a supposed

⁷⁶ See Tippet, "Financing the Exploration for Oil & Gas," 9 Rocky Mt. Mineral Law Inst. 297 (1964).

⁷⁷ Loss, *op. cit. supra* note 70, at 662.

⁷⁸ See *Collier v. Mikel Drilling Co.*, 183 F. Supp. 104 (D. Minn. 1958).

⁷⁹ *Gilligan Will & Co. v. SEC*, 267 F.2d 461 (2d Cir. 1959).

⁸⁰ SEC Securities Act Release No. 33-4552, Nov. 6, 1962.

⁸¹ *SEC v. Ralston Purina Co.*, *supra* note 71; *Repass v. Rees*, *supra* note 66.

⁸² SEC Securities Act Release No. 33-4552, Nov. 6, 1962.

exemption. In addition, the sections of the act providing civil and criminal liability for fraud in the sale of the security would be applicable notwithstanding the exemption from registration requirements.⁸³

Intrastate Offerings

Most exemptions from the operation of the Securities Act of 1933 are very narrow and cannot be relied on in the sale of oil and gas securities. The so-called "intrastate exemption" however is very pertinent. This exemption excepts:

Any security which is a part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within or, if a corporation, incorporated by and doing business within, such State or Territory.⁸⁴

It should be noted that the language of the act makes the exemption depend on the place of residence of both the seller and purchaser. Thus, residence controls, not the intrastate nature of the transaction. This means that instrumentalities of interstate commerce and the mails may be used in the transaction without destroying the exemption.⁸⁵ The residence requirement applies to *both* the purchaser and the issuer. When a corporation is involved it must be incorporated in the state of the offering and be doing business in that state. With a view to the latter requirement, some officials have questioned the status of a corporation making its original offering when the corporation was formed solely for the purpose of selling oil and gas interests.⁸⁶

The primary problem arising in the application of the intrastate exemption occurs when one of the original resident purchasers subsequently sells the securities to a nonresident. The Securities and Exchange Commission has stated that "it is clearly required that the securities at the time of completion of ultimate distribution shall be found only in the hands of investors resident within the state."⁸⁷ In other words, if the original purchaser buys with a view to resale, one looks to not only his residency, but also to the residency of the

⁸³ *Ibid.*

⁸⁴ 48 Stat. 74 (1933), 15 U.S.C. § 77c(11) (1964).

⁸⁵ Section 5(c) of the original act, prior to its repeal by the Act of June 6, 1934, 48 Stat. 906, expressly stated that the sections relating to the use of the mails did not apply where the issue is sold only by and to persons resident of a single state.

⁸⁶ Address prepared by Messrs. John W. Vogel and Orazio Sipari, Attorneys for the Securities and Exchange Commission, presented at the Ohio Legal Center Institute Conference on Oil & Gas, held in Columbus, Ohio, in June, 1964.

⁸⁷ SEC Securities Act Release No. 33-201, July 20, 1934.

purchasers who ultimately buy for investment. If one of these persons or an intermediate purchaser is a nonresident, the exemption is defeated. The length of time which elapses between the original purchase and the resale is an element of evidence used to determine his real purpose in purchasing the security.⁸⁸

Also to be considered in a discussion of the intrastate exemption is the "issue" concept. The language of the exemption requires that the entire issue be sold to persons within a single state.⁸⁹ If a part of an issue is offered outside of the state the exemption is lost. Whether a sale is part of a larger offering, is a question of fact to be determined in each case.⁹⁰ State law does not control.⁹¹

If two offerings appear part of a single plan of financing, *i.e.*, if the common purpose of issuing the same type of security at approximately the same time is found to exist, it is likely that both offerings will be considered to be part of the same issue. In that situation, if the intrastate exemption is to apply, all of the prerequisites thereto must be met by *both* offerings comprising the issue.⁹²

Limited Registration—Regulation B

The Securities and Exchange Commission has created a conditional exemption for offerors of fractional undivided interests in oil and gas rights. Eligibility therefor is conditioned upon the filing of an offering sheet describing the security involved and the delivery of such offering sheet to every person to whom the offering is made whether such person becomes a purchaser or not.⁹³ This is the so-called "Regulation B" exemption. It actually amounts to a provision for limited registration with the SEC since the securities are not in fact exempt unless the offering sheet is filed.

The amount of the offering cannot exceed 100,000 dollars.⁹⁴ The offering sheet, which must be filed with the SEC before any sale is made, becomes effective on the eighth day following the date of its receipt by the Commission.⁹⁵ In practice, however, it is common for the Commission staff to make comments regarding deficiencies in the offering sheet in order that suspension of the effectiveness of a filing might later be avoided.

Within fifteen days after a sale or contract for sale is made, the offeror is required to file a written report of the sale on Form

⁸⁸ SEC Securities Act Release No. 1459, May 29, 1937.

⁸⁹ 48 Stat. 74 (1933), 15 U.S.C. § 77c(11) (1964).

⁹⁰ SEC Securities Act Release No. 33-4434, Dec. 6, 1961.

⁹¹ *Shaw v. United States*, 131 F.2d 476 (9th Cir. 1942).

⁹² SEC Securities Act Release No. 33-4434, Dec. 6, 1961.

⁹³ SEC Reg. B, 17 C.F.R. §§ 230.300-356 (1964).

⁹⁴ SEC Reg. B, 17 C.F.R. § 230.310 (1964).

⁹⁵ SEC Reg. B, 17 C.F.R. § 230.342 (1964).

1-G.⁹⁶ These reports are ordinarily kept confidential unless the Commission orders otherwise.

The offering sheets differ according to the type of oil or gas interest involved. All information contained in the offering sheet must be as of a date not more than 110 days prior to the delivery of the sheet to the purchaser or to the date of the sale. The offering sheet expires 110 days after the date of information contained therein.⁹⁷ Prior to the expiration of the 110-day period, new information may be added to amend the offering sheet and to extend the effective date thereof *only* if no sales have been made. After sales have been made no amendment is possible; a new offering sheet must be filed if the unsold portion of an offering is to be sold after the expiration of the first offering sheet.

Another condition determining the applicability of Regulation B is that prior to the completion of the sale the offeror must deliver to the prospective purchaser satisfactory evidence that the title to the purchased interest is valid.⁹⁸ It is not clear what evidence is sufficient to meet this requirement. Presumably, however, if fractional undivided leasehold interests are involved, a title opinion by an attorney showing good title in the offeror (or right to obtain such title) would suffice.

The Regulation B exemption is not available unless the operating lessee or lessees will own a working interest in the involved tracts equal to the greater of (a) 20 per cent of total production from such tract, or (b) the total percentage of production from such tract which is not subject to any portion of the expense of development, operation, or maintenance.⁹⁹ This limitation does not apply if the aggregate value of the issue offered to the public does not exceed 30,000 dollars and if the smallest interest which is offered is not offered for less than 300 dollars.¹⁰⁰

The term "operating lessee or lessees" is defined to include a lessee of record who is actually engaged in developing the tract as well as all other owners of a working interest in the tract who are regularly engaged in the business of exploring for or producing oil and gas and who have consented in writing to the development and operation of the tract by the lessee of record.¹⁰¹ The latter provision covers the situation where the operating lessee has entered into an operating agreement with the other owners of a working interest in

⁹⁶ SEC Reg. B, 17 C.F.R. § 230.320 (1964).

⁹⁷ SEC Reg. B, 17 C.F.R. § 230.330 (1964).

⁹⁸ SEC Reg. B, 17 C.F.R. § 230.330(d) (1964).

⁹⁹ SEC Reg. B, 17 C.F.R. § 230.314(a) (1964).

¹⁰⁰ SEC Reg. B, 17 C.F.R. § 230.314(b) (1964).

¹⁰¹ SEC Reg. B, 17 C.F.R. § 230.314(c) (1964).

the tract. If any information required by the Commission is not supplied, the Commission must be given a full explanation of the omission. Statements and information contained in the offering sheets constitute continuing representations by the persons filing the offering sheet.¹⁰²

Limited Registration—Regulation A

Under the authority of section 3(b) of the act the SEC has adopted a second limited exemption in addition to Regulation B called "Regulation A."¹⁰³ The exemption was adopted in 1956 by the Commission to cover issues of certain types of securities where the value of the issue does not exceed 300,000 dollars.¹⁰⁴

Expressly excluded from Regulation A operation are fractional undivided interests in oil or gas rights as defined in Regulation B. However some oil and gas financing methods could fall within the scope of Regulation A. If, for instance, the promoter transfers the oil and gas interests to a corporation or other type of business organization within the regulation's coverage, the sale of interests in the organization would not be the sale of oil and gas rights. Hence, if the other requirements were met, the sale could be subject to the limited filing requirements of Regulation A. A Securities Form 1-A must be filed with the Regional Office of the SEC at least ten days prior to the date of initial offering of any securities to be made under Regulation A.¹⁰⁵

Registration Under the Act

When an offering does not fall within any of the exemption categories and the offering is of a type and magnitude which precludes limited registration under Regulation B or Regulation A, the promoter must make a standard registration of the offering with the SEC.

Registration is accomplished by the filing of a registration statement in the form prescribed by the Commission. When the offering involves oil and gas interests the Securities Form S-10 is used. This form requires a detailed description of the interests involved in the offering and all pertinent information about such interests. The prospectus to be given to each offeree is required as a part of the registration statement.

The usual oil and gas securities registration under Form S-10 is handled by the SEC in the same way as other registrations. The

¹⁰² SEC Reg. B, 17 C.F.R. § 230.332(a) (1964).

¹⁰³ 48 Stat. 74 (1933), 15 U.S.C. § 77c(b) (1964). This section gives the Commission the power to add exceptions by rules and regulations where the aggregate amount of the offering is less than \$300,000.

¹⁰⁴ SEC Reg. A, 17 C.F.R. § 230.252(b)(1) (1964).

¹⁰⁵ SEC Reg. A, 17 C.F.R. § 230.255 (1964).

offeror must await effective registration before selling or attempting to sell the securities being registered.¹⁰⁶

Although the act provides that the registration statement shall be effective on the 20th day after filing thereof, usually the staff of the SEC will, prior to the expiration of the twenty-day period, make comments regarding the statement so that the statement may be amended. If an amendment to the registration statement is filed prior to the effective date of the registration statement, the effective date shall be 20 days after the date of amendment.¹⁰⁷ The Commission is authorized to accelerate the effective date, if it feels that the information presented is adequate and if it determines that such acceleration would be consistent with the public interest and to the protection of the investor.¹⁰⁸

A registration statement must be filed in triplicate and must be signed by the issuer or its principal executive officer or officers.¹⁰⁹ A fee of 1/100th of one per cent of the maximum aggregate price of the offering is prescribed with a minimum of 25 dollars.¹¹⁰ The date of filing is the date that the Commission receives the registration statement and the required fee.

The S-10 Registration Statement requires several exhibits including a plat of the involved tract and surrounding area indicating lease boundaries, farm names, and operators of leases. In addition, the plat must portray the location and spacing of all producing wells, wells being drilled, abandoned wells, and dry holes with the depth of each noted thereon. As in the case of a Regulation B offering sheet, an attorney's opinion as to the validity of title of the security being registered must be furnished as an exhibit to the S-10 registration statement. Copies of all contracts and leases involved in the registration and a specimen copy of the agreement by which the interests are to be conveyed must also accompany the registration statement.

Reference should be made to the applicable SEC form and instructions for other specific requirements of S-10 registration.

CONCLUSION

Oil and gas promoters and others involved in financing the development of oil and gas properties must consider the effect of the Ohio Securities Act and the Securities Act of 1933 on their financing operations. The general purpose of both laws is to protect

¹⁰⁶ 48 Stat. 74 (1933), 15 U.S.C. § 77e(a) (1964).

¹⁰⁷ 48 Stat. 74 (1933), 15 U.S.C. § 77h(a) (1964).

¹⁰⁸ *Ibid.*

¹⁰⁹ 48 Stat. 74 (1933), 15 U.S.C. § 77f(a) (1964).

¹¹⁰ 48 Stat. 74 (1933), 15 U.S.C. § 77f(b) (1964).

the investor through complete disclosure of pertinent information. The protective policy is extended further under the Ohio Securities Act in that the Securities Division has the power to determine whether or not the sale of securities is "grossly unfair" within the terms of the Ohio Securities Act.

The exemptions offered under both acts are very narrow and are construed strictly against the issuing parties.

Violations of either act give rise to criminal penalties and civil liabilities which can make noncompliance extraordinarily costly. Under both laws the noncomplying seller of unregistered securities becomes, in effect, the guarantor of financial gain for his investors since under both acts the investors may rescind the transactions and obtain a refund in the amount of the purchase. The regulatory agencies involved recommend that all doubts be resolved in favor of registration. Certainly the authority, and lack of it, interpreting both the Ohio Securities Act and the Securities Act of 1933 support such a conclusion.